80-2143

No. _____

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ALEXANDER L. STEVAS,
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIAN E. O'NEILL, *Senior Vice President and General Counsel*
R.V. LOFTIN, JR.
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
P.O. Box 1396
Houston, Texas 77001

THOMAS F. RYAN, JR.*
RICHARD T. BOONE
ANDREWS, KURTH, CAMPBELL & JONES
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 861-7400

Attorneys for
Transcontinental Gas Pipe Line Corporation

June 17, 1981

*Counsel of Record.

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QUESTIONS PRESENTED

1. Whether, if the Commission is required to satisfy Section 5(a) of the Natural Gas Act prior to changing a settled component of a pipeline's rates (such as the method of allocating costs among zones), the Commission is also required to satisfy Section 5(a) prior to reducing a pipeline's previously allowed level of rate of return on common equity.

2. Whether the Commission may substantially reduce previously allowed levels of rate of return on equity without explanation of such departure from precedent and with no claim of changed circumstances justifying such departure.*

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* In addition to the parties named in the caption of this case the following were parties to the proceeding in the court of appeals: Atlanta Gas Light Company, Brooklyn Union Gas Company, Carolina Pipeline Company, Columbia Gas Transmission Corporation, Commonwealth Gas Pipeline Corporation, Consolidated Edison Company of New York, Inc., Elizabethtown Gas Company, Long Island Lighting Company, National Fuel Gas Supply Corporation, North Carolina Natural Gas Corporation, North Carolina Utilities Commission, Philadelphia Electric Company, Philadelphia Gas Works, Piedmont Natural Gas Company, Inc., Public Service Commission of the State of New York, Public Service Company of North Carolina, Inc., Public Service Electric and Gas Company, South Jersey Gas Company and Washington Gas Light Company.

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Section 4
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No. _____

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

On May 18, 1981 in the captioned proceedings the Solicitor General, on behalf of the Federal Energy Regulatory Commission (Commission), the North Carolina Utilities Commission (NCUC) and North Carolina Natural Gas Corporation, *et al.* (NCNG, *et al.*) petitioned for writs of certiorari to review a portion of the judgment of the United States Court of Appeals for the District of Columbia Circuit in *The Public Service Commission of the State of New York, et al.* v. *Federal Energy Regulatory Commission,* 642 F.2d 1335 (D.C. Cir. 1980). Transcontinental Gas Pipe Line Corporation (Transco) hereby cross-petitions for a writ of certiorari

to review a separate but inconsistently decided portion of the same judgment so that, if the foregoing Petitions are granted, the Court will have the entire case before it in order that it may apply the same principles to the two issues.[1]

OPINIONS AND ORDERS BELOW

The opinion of the court of appeals (FERC Pet. App. A, at pp. la-27a[2]) is reported at 642 F.2d 1335. The orders of the Commission which are pertinent to the instant Cross-Petition are not reported and appear in Appendices A and B hereto, at pp. la-2a and p. 3a, respectively. The decision of the administrative law judge which was adopted by the Commission is not reported and appears in Appendix C hereto, at pp. 4a-19a.

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[1] In accordance with Rule 28.1, Transco states that it is a wholly owned subsidiary of Transco Companies, Inc. and has the following subsidiaries or affiliates: Alapost; Border Gas, Inc.; C&T Pipeline, Inc.; Dixie Pipeline Company; Gasco Insurance Company, Limited; TCI Realty, Inc.; Towtrans Company; Transco Coal Gas Company; Transco Energy Company; Transco Exploration Company; Transco Gas Supply Company; Transco Hydrocarbon Company; Transco International N.V.; Transco LPG Company; Transco Offshore Pipeline Company; Transco Propane Supply Company; Transco Production of Canada, Ltd.; Transco Propane Products Company; Transco Terminal Company; Trans-Jeff Chemical; Tubexpress Systems, Inc.

[2] Copies of the opinion and orders of the court below and the pertinent statutory provisions required by Rule 21.1(k) appear in an Appendix to the Petition for a Writ of Certiorari filed on May 17, 1981 by the Solicitor General on behalf of the Commission in 80-1937. In this Cross-Petition, references to "the Commission" or citations to "FERC Pet." are to that pleading. The portions of the opinion of the court below which are pertinent to the issues raised in this Cross-Petition are reported at 642 F.2d at 1348-1351, and appear at FERC Pet. App.A, pp.21a-26a and FERC Pet.App.C, pp.32a-33a.

JURISDICTION

The judgment of the United States Court of Appeals for the District of Columbia Circuit was entered on September 24, 1980. A timely petition for rehearing and a suggestion for rehearing *en banc* by Transco were denied on December 18, 1980. NCUC, on May 15, 1981, and the Commission and NCNG, *et al.*, on May 18, 1981, petitioned this Court for writs of certiorari in this case. Transco received NCUC's Petition on May 18, 1981 and received the Petitions of NCNG, *et al.*, and of the Commission on May 21, 1981. The instant Cross-Petition to those Petitions is filed pursuant to Rule 19.5 of this Court's Rules. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 4 and 5(a) of the Natural Gas Act, 15 U.S.C. §§717c and 717d(a), are set forth in FERC Pet. App. I, at pp. 63a-65a.

STATEMENT OF THE CASE

Transco is a major interstate natural gas pipeline system which is subject to regulation as to service and rates by the Commission under the Natural Gas Act. Transco owns and operates extensive pipeline facilities which are utilized to transport gas from the sources of Transco's gas supplies, located in the Gulf Coast area, primarily to wholesale markets along the eastern seaboard of the United States from Atlanta, Georgia to New York City.

The questions presented by this Cross-Petition and the Petitions filed by the Commission and other parties arise from a proceeding in which Transco initiated a

general rate increase pursuant to Section 4(d) of the Natural Gas Act on July 30, 1976. After suspension by the Commission pursuant to Section 4(e) of the Act, Transco's increased rates became effective, subject to refund, on February 1, 1977.[3] As part of its rate increase, Transco proposed an increase in its allowed rate of return on equity capital from the previously allowed level of 14.75 percent to 17.00 percent. Transco did not propose any changes in the long-standing method used to allocate costs among the rate zones on its system. The increase in Transco's proposed equity return was occasioned by increased risks associated with Transco's business resulting from the severe shortage of natural gas as well as overall economic conditions characterized by rapidly increasing costs and rampant inflation. Ultimately, most of the issues in the proceeding before the Commission were resolved by settlement, but the issue of the justness and reasonableness of Transco's proposed increase in its allowed rate of return and a complaint that Transco's existing zone rate differentials were unlawful were reserved for separate hearings and decision.

In a separate rate of return hearing, Transco introduced evidence in support of its claimed equity return of 17.00 percent. The staff of the Commission was the only other party to introduce evidence on the issue and recommended an equity return for Transco of 14.00 percent, or three-quarters of a percentage point *below* the level of equity return allowed by the Commission in Transco's three immediately preceding rate cases. On

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[3] On July 1, 1977, Transco filed a superseding rate increase which, after suspension by the Commission, was allowed to become effective, subject to refund, on January 1, 1978. Therefore, the instant rates were effective for the eleven-month period from February 1, 1977 through December 31, 1977.

February 13, 1978, the administrative law judge (ALJ) issued an initial decision, holding that Transco's proposed rate of return of 17.00 percent was not justified and, notwithstanding his holding that "Transco poses greater risks to investors than does virtually any other pipeline company" (App. C, p. 14a), not only disallowed the entire proposed increase in return but also significantly reduced the previously allowed level of 14.75 percent to 14.00 percent.[4] In deciding the issue, the ALJ dismissed Transco's argument that there was no evidence of changed circumstances that would rationally permit any reduction from the 14.75 percent level of return on equity previously allowed to Transco with the statement that such previous allowances were produced by settlement and would not be considered. (App. C, p. 12a).

Transco appealed the ALJ's decision to the Commission, arguing that the ALJ had erroneously failed to consider Transco's consistently allowed rate of return on equity of 14.75 percent as the point of reference in evaluating the evidence of the Commission staff's witness, who gave no rationale whatsoever in support of his recommended reduction in previously allowed returns to Transco. Transco also argued that the ALJ had erred in several respects in evaluating Transco's evidence supporting the proposed increase in allowed equity return. Indeed, the ALJ's analysis in the initial decision was so cryptic that Transco contended the Commission could not determine from the initial decision the facts which were relied on by the ALJ or the reasoning, if any, based on such facts. Nevertheless, on August 30, 1979,

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[4] The difference of 0.75 percentage points amounts to about $4.8 million in revenues for the eleven-month period the rates at issue were in effect.

the Commission, in a one-page order which contained no explanation for its decision, affirmed and adopted the decision of the ALJ. (App. A).

Transco appealed the Commission's rate of return orders to the court below. The Commission's decision on the zone rate differential issue was also appealed by representatives located in Zone 3[3] and, because of the coincidental timing of the separate decisions by the Commission, the two issues were consolidated in the court below. On September 24, 1980, the court below reversed the Commission's decision which rejected Transco's historical zone rate differentials, finding that the Commission had failed to satisfy the strictures of Section 5(a) of the Natural Gas Act before imposing its own cost allocation methodology. Specifically, the court held:

> Had Transco proposed any changes in them [the existing zone rate differentials], the Commission, acting under Section 4(e), could have approved the changes in whole or in part. *Section 4(e), however, cannot be used by the Commission to institute any change in a rate-making component, such as cost allocation, that does not represent at least partial approval of the change for which the enterprise had petitioned in its filing.* If the Commission seeks to make such changes, it has no alternative save compliance with the strictures of Section 5(a).

FERC Pet. App. C, pp. 32a-33a (emphasis supplied). However, with respect to the rate of return issue, the

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[3] As more fully explained in the Petitions filed by the Commission, NCUC and NCNG, *et al.*, Transco's system is divided into three rate zones. The decision of the Commission in its Opinion No. 59 (FERC Pet. App. F, pp. 36a-52a), vacated by the court below, shifted significantly greater costs to Zone 3 from Zones 1 and 2 than the previous historical method of allocation.

court below, while paying lip-service to the Section 4-Section 5 dichotomy in analyzing the issue, erroneously held that the Commission had satisfied Section 5(a)'s requirements. Concerning the applicable legal standard on the rate of return issue, the court stated:

> [W]hen the Commission not only voids a proposed rate increase, but institutes a rate of its own under Section 5(a) rather than continuing the old rate in effect, it must advance substantial evidence to prove (1) that the old rate is unjust and unreasonable and (2) the Commission's proposed rate is just and reasonable.

FERC Pet. App. A, pp. 24a-25a n. 27. However, in sharp contrast to its detailed examination of the rationale offered by the Commission in Opinion No. 59 for rejecting Transco's historical zone differentials, the court below affirmed the Commission's cursory rate of return orders even though the Commission had *explicitly refused* to explain why Transco's previously allowed rate of return on equity had become unjust and unreasonable. Moreover, although the court below appeared to have recognized the applicability of Section 5(a) when the Commission proposes to reduce previously allowed rates of return, the court inexplicably held that its decision in *Columbia Gas Transmission Corp., et al* v. *Federal Energy Regulatory Commission,* 628 F.2d 578 (D.C. Cir. 1979), was inapplicable to rate of return determinations even though the *Columbia Gas* precedent was found to be fully applicable to other previously established rate components that the Commission proposes to change.

REASONS FOR GRANTING THE WRIT

1. The Court Should Review The Entire Case To Resolve The Inconsistent And Conflicting Standards Applied By The Court Below

Uniform decisionmaking requires that this Court grant the instant Cross-Petition if the Petitions submitted by the Commission and/or the other parties concerning the decision by the court below on zone rate differentials are granted. The Commission as well as the other petitioners have raised issues which not only bear on the discrete issue of cost allocation but also all other rate components, including rate of return. Since the court below appears to have analyzed both aspects of this case in the same fashion and yet resolved each in an inconsistent and conflicting manner, we believe that this Court should review the entire case if the Court determines to grant the petitions filed by the Commission or the other parties in order to prevent confusion in the administration of the Natural Gas Act.

While the court below has in Transco's view correctly decided with respect to the zone differential issue that as a matter of law the Commission must proceed under Section 5(a) of the Natural Gas Act to the extent that it proposes to institute a change in any rate component for which the regulated pipeline has not applied, the court has *not* been consistent in requiring the same observation of Section 5(a)'s requirements from the Commission with respect to the changes which it proposed in Transco's previously allowed rate of return on equity.[6]

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[6] While Transco did propose an increase in its allowed rate of return and did not propose a change in its historical zone rate differentials, this factual difference is irrelevant to the procedures that the Commission is required to follow when proposing to reduce

In effect, the decision below erroneously holds that Section 5(a) establishes a legal standard which changes in meaning depending upon the subject matter to which its procedures are applied. It is therefore necessary that this Court issue the writ, if at all, to review the decision below on both the rate of return issue and the zone rate differentials issue to clarify the confusing and fundamentally inconsistent meaning which the court below has ascribed to Section 5(a) of the Natural Gas Act.

Section 5(a) of the Act allows the Commission to investigate the lawfulness of existing rate components and, only after finding that the rate or rate component so investigated is "unjust, unreasonable, unduly discriminatory or preferential," allows the Commission to determine the just and reasonable rate to be thereafter effective. This Court has previously addressed the fundamental powers of the Commission under Section 5(a) of the Act and differentiated such powers from those set forth in Section 4(e) of the Act:

> The powers of the Commission are defined by §§4(e) and 5(a). The basic power of the Commission is that given it by §5(a) to set aside and modify any rate or contract which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential.' *** It is simply the power to review rates and contracts made in the first instance by

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Transco's *previously established* level of rate of return. The court below correctly distinguished between setting aside Transco's entire proposed increase and in reducing the previously allowed level of return. (FERC Pet. App. A, pp. 24a-25a n. 27). The Court's distinction is valid because pipelines should properly be allowed to propose increased rates of return without jeopardizing their pre-existing levels of return to any greater extent than such established levels are subject to investigation and prospective change under Section 5(a) of the Natural Gas Act.

> natural gas companies and, if they are determined to be unlawful, to remedy them. Section 5(a) would of its own force apply to *all* the rates of a natural gas company, whether long-established or newly changed, but in the latter case the power is further implemented by §4(e). All that §4(e) does, however, is to add to this basic power, in the case of a newly changed rate or contract . . ., the further powers (1) to preserve the status quo pending review of the new rate by suspending its operation for a limited period, and (2) thereafter to make its order retroactive, by means of the refund procedure, to the date the change became effective.

United Gas Pipe Line Co. v. *Mobile Gas Service Corp.*, 350 U.S. 332, 341 (1956). Thus, when the Commission proceeds under Section 5(a) rather than under Section 4, as the court below correctly held the Commission must when contemplating a reduction in the previously approved level of a pipeline's rate of return component, it must focus on the established rate component being investigated and make findings based on substantial evidence that such existing level is unjust or unreasonable. However, even a cursory reading of the Commission's rate of return order (App. C, p. 12a) evidences a total disregard by the Commission for the requirement to focus on the established rate of return allowed Transco in previous cases. In the face of the Commission's stated refusal to give a reasoned explanation for rejecting Transco's previous rate of return allowance, the affirmance of the Commission's rate of return orders is inexplicable.

Section 5(a) of the Natural Gas Act cannot have a different meaning with respect to rate of return determinations than it has with respect to cost allocation determinations by the Commission. Regardless of the subject matter, the structure of the Act fairly con-

templates that, once established, a pipeline's existing rates, and any component thereof, constitute the point of departure against which any contemplated or proposed change, whether it be an increase or a decrease, must be measured. *See, Columbia Gas Transmission Corp., et al.* v. *Federal Energy Regulatory Commission,* 628 F.2d 578, 585-586 (D.C. Cir. 1979). The court below held, however, that the principle of *Columbia Gas* did not apply to the Commission's proposed reduction of Transco's previously approved rate of return of 14.75 percent.[7] The court's attempted distinction of the requirements of *Columbia Gas* was based on the supposed fact that with respect to the zone rate differentials issue "the Commission was choosing between present practice and a discrete alternative" (FERC Pet. App. A, p. 25a), but that with respect to the rate of return issue the Commission was faced with an "infinitude of choices." (*Id.*). This attempted distinction is a makeweight. With respect to the zone rate differential issue, the administrative record below contained evidence supporting more than the two alternatives noted by the court. The number of alternatives confronting the Commission on a particular issue is simply irrelevant to the obligation to explain a rejection of the previously established rate component that the Commission proposes to change.

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[7] The court below held that "[t]he Commission's conclusion that only rates between 13.5% and 14.3% are just and reasonable" (FERC Pet. App. A, p. 25a, n.27) fulfilled the requirement of Section 5(a) for findings that Transco's 14.75 percent return was unlawful. However, the referenced findings by the Commission were totally independent of any consideration of Transco's previously allowed return, the latter having been explicitly *not considered* by the Commission (App. C, p. 12a). In any event, such "finding" does not explain what, if anything, rendered the previously allowed level of return unlawful.

The determinative fact is that one, and only one, cost allocation method had been employed historically by Transco against which all other proposed methodologies could be judged. Similarly, a single, discrete rate of return allowance (*i.e.*, 14.75 percent) had been approved consistently in determining Transco's rates in previous cases and, under the *Columbia Gas* rule, this component represents the proper point of departure in analyzing both the need for and propriety of any change therein. That the Commission had consistently allowed a rate of return on equity of 14.75 percent in Transco's three immediately preceding rate cases establishes a no less concrete point of departure than the Commission's approval of Transco's historical zone allocation method in those cases. Given the similarity of the issues, therefore, there is no rational basis for the court below to have attempted *sua sponte* to characterize the Commission's prior approval of Transco's rate of return as somehow less than a settled, existing and lawful point of departure for reviewing any substantial reduction thereof.

The Petitions submitted by the Commission, NCUC and NCNG, *et al.*, each focus on the remedial consequences that may flow from the decision by the court below that the Commission must proceed under Section 5(a) of the Natural Gas Act rather than under Section 4 in situations where established rate components are proposed to be changed *sua sponte* by the Commission.[8] The characteristics of the remedy available under Section 5(a) of the Act have been previously recognized by this Court. *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 389-390 (1959). A perceived inade-

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[8] In Opinion No. 59, the Commission made its decision to change Transco's zone differentials effective on a prospective basis as if it were deciding the case under Section 5(a).

quacy of the remedial powers delegated by Congress to the Commission, however, cannot thwart the procedures that Congress has mandated the Commission to follow in reviewing the rates of natural gas companies; the character of the rate investigated, rather than the adequacy of the Commission's remedy, must determine the statutory provision under which the Commission must proceed. In any case, the statutory construction issue raised by the Commission and other petitioners is almost beside the point, because on the zone rate differential issue the alternative decisional ground of the court below, *i.e.*, that "[i]n any event, the evidence of record supporting [the Commission's prescribed method of cost allocation] falls short of substantiality" (FERC Pet. App. A, p. 21a), is clearly correct. This case presents, first and foremost, the threshold question whether the findings of the Commission on both rate issues, and the rationale and evidence supporting them, are consistent with and adequate under the Natural Gas Act and general principles of administrative decisionmaking. We contend that the court below failed to require the Commission to demonstrate the same caliber of reasoned decisionmaking on the rate of return issue as it required on the zone differential issue. This inconsistency in the reasoning of the court below is inexplicable, will lead to confusion in the future administration of the Natural Gas Act, and presents a question the resolution of which by this Court is imperative.

2. The Resolution Of The Questions Presented Is Necessary To Provide Guidance To Courts Of Appeals On The Proper Standard Of Review Of Administrative Decisionmaking

In its Petition, the Commission states that the importance of the case rests in the allegedly erroneous con-

struction of Sections 4 and 5(a) of the Natural Gas Act by the court below. (FERC Pet., pp. 7-9). However, it is Transco's view that, regardless of the correct interpretation of the statutory bases for Commission-initiated ratemaking imposed upon a natural gas pipeline, the instant proceeding presents the more fundamental question of the procedures which administrative agencies, specifically the Commission in this case, are required to observe when engaging in administrative ratemaking. This larger issue is extremely important because in complex and very technical rate proceedings before agencies, where a great deal of deference is typically afforded to the agency's expertise, effective judicial review is the *only* protection against arbitrary and potentially damaging administrative decisions. Strict adherence to the requirement of *reasoned* decisionmaking is, therefore, essential if judicial review is to be effective. Thus, the importance of the instant case not only rests in the proper construction of the provisions of the Act but also the adequacy *vel non* of the Commission's decisionmaking regardless of the outcome on review of the statutory issue.

This Court has consistently held that judicial review of the Commission's rate of return determinations under the "end result" principle set forth in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944), is not to be perfunctory. *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 605 (1945). Rate of return determinations, no less than any other agency determination, must set forth the pertinent facts relied upon and the reasoning based on such facts which resulted in the agency's decision. *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968). Further, effective judicial review requires that the Commission's order itself evidence that the agency has engaged

in the fact-finding and reasoning requisite to sustaining the orders on review. It is self-evident that an appellate court cannot properly step in and supply the agency's missing rationale. *Securities and Exchange Commission* v. *Chenery Corp., et al.,* 318 U.S. 80, 88 (1943). The foregoing principles are applicable regardless whether the Commission was empowered to act under Section 4 of the Act, as the Commission and the other petitioners contend, or under Section 5(a), but the requirements are particularly important where, as in this case, the Commission proposes to set aside an established rate component.

That the Commission determined a so-called "zone" of reasonable rates of return — the limits of which were neither proposed by any witness nor explained by the Commission as being based on evidence in the administrative record — which was below the previously allowed 14.75 percent level of return is not an explanation of why the previous "just and reasonable" return allowed Transco has become "unjust, unreasonable, unduly discriminatory or preferential." As this Court held in *Mobile Gas*, 350 U.S. at 341, it is not the Commission's function to disregard the rates established by regulated pipelines but rather to review those established rates and, *only if they are found unjust or unreasonable,* is the Commission empowered to initiate new rates of its own design. At a minimum, therefore, effective judicial review of the rate of return order herein demands that the Commission have confronted head-on the issue of the reasonableness of Transco's established 14.75 percent return and, addressing this previous allowance on its merits, explained the basis, if any, for its conclusion that Transco's pre-existing 14.75 percent allowed equity return had become unlawful. Because the court failed to require such an explanation, evidencing the prefunctory

nature of its review of the Commission's decisionmaking, it is important that this Court establish firm guidelines for judicial review of Commission orders which purport to discard existing and lawful rates of return reflected in the rates of regulated companies and establish substantially lesser levels of return.

In Transco's view, effective judicial review of any Commission determination to reduce substantially a pipeline's previously allowed rate of return requires that the Commission make a threshold finding that changed circumstances require and support the proposed reduction. If established rate components are to be truly considered the point of departure in reviewing decisions to change such components, as the court below held in *Columbia Gas, supra,* the Commission, in cases where a reduction of previously allowed rates of return is contemplated, must offer or rely upon some proof that the pre-existing rate level allowed has become excessive and explain the reasoning which led to such conclusion. Stated differently, if effective judicial review depends on an explanation of why an existing and lawful rate level has become unlawful, then an explanation of the changes bearing on such a conclusion is indispensable to effective review.[9] The Commission's refusal to consider Transco's previously allowed 14.75 percent rate of return allowance in this case (App. C, p. 12a), therefore, should have been recognized by the court below as an insuperable barrier to effective judicial review of the Com-

[9] This requirement is consonant with that which the Commission requires of applicants for an increase in previous rate of return allowances where the burden of proof is on the applicant. *See, Minnesota Power & Light Co.* (Opinion No. 87), issued on June 24, 1980 in FERC Docket No. ER77-427, *mimeo*, p. 3; *see also, Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 236 F.2d 606, 612 (3d Cir. 1956).

mission's attempt to reduce Transco's previously allowed return on equity capital allowance and the court below should properly have reversed and remanded the Commission's rate of return orders. Since it did not, and because the court below arrogated to itself the task of supplying for the Commission the analysis requisite under settled law, this Court should, if it grants the Petitions filed on the zone differential issue, grant the instant Cross-Petition and clarify the correct standard of judicial review binding on courts of appeal concerning review of Commission decisionmaking under either Section 4 or Section 5(a) of the Act.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that in the event the Court should grant the Petitions for writs of certiorari in Nos. 80-1937, 80-1938 and 80-1939, this Cross-Petition for a writ of certiorari should likewise be granted.

Respectfully submitted,

BRIAN E. O'NEILL, *Senior Vice President and General Counsel*
R.V. LOFTIN, JR.
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
P.O. Box 1396
Houston, Texas 77001

THOMAS F. RYAN, JR.
RICHARD T. BOONE
ANDREWS, KURTH, CAMPBELL & JONES
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 861-7400

Attorneys for
Transcontinental Gas Pipe Line Corporation

June 17, 1981

APPENDIX

APPENDIX A

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. RP76-136 and RP77-26

Before Commissioners:

GEORGIANA SHELDON, *Acting Chairman;*
MATTHEW HOLDEN, JR.,
and GEORGE R. HALL.

TRANSCONTINENTAL GAS PIPE LINE CORPORATION (TRANSCO)

ORDER AFFIRMING AND ADOPTING INITIAL DECISION
(Issued August 30, 1979)

On February 13, 1978, the presiding administrative law judge issued an initial decision in the above-captioned proceeding as to the issues of rate of return on common equity and carrying charges on unrecovered demand charge credits. We agree with the initial decision on all questions presented and find nothing in the exceptions thereto warranting further discussion.

The Commission orders:

(A) The initial decision of the administrative law judge is affirmed and adopted.

(B) Within 60 days, Transco shall file revised tariff sheets and rates in accordance with the terms of the initial decision and of this order.

(C) Within 30 days after acceptance of the revised tariff sheets and rates submitted pursuant to paragraph (B) above, Transco shall refund to its jurisdictional customers all amounts collected in excess of the approved rates together with interest at the rate of nine percent per annum. Within

ten days thereafter, Transco shall submit a report setting forth the calculation of refunds and interest paid.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Secretary.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. RP76-136 and RP77-26

TRANSCONTINENTAL GAS PIPE
LINE CORPORATION (TRANSCO)

NOTICE OF DENIAL OF APPLICATION FOR REHEARING AND MOTION FOR STAY
(Issued October 24, 1979)

On September 28, 1979, Transco filed an application for rehearing and a motion for stay of the Commission's order, issued on August 30, 1979, in the above-referenced docket.

Take notice that the Commission agreed at its meeting of October 17, 1979, to take no action on the above-mentioned application for rehearing and motion for stay.

Accordingly, the application for rehearing is deemed denied under section 1.34(c) of the Commission's Rules of Practice and Procedure. (18 CFR §1.34(c)). The motion for stay is deemed denied under section 1.12(e) of the Commission's Rules of Practice and Procedure. (18 CFR §1.12(e)).

Kenneth F. Plumb,
Secretary.

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. RP76-136 and RP77-26

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

INITIAL DECISION ON RESERVED ISSUES

(February 13, 1978)

APPEARANCES

Thomas F. Ryan, Jr., Robert G. Hardy and *Brian E. O'Niell* for Transcontinental Gas Pipe Line Corporation

John D. Daly, Jr., and *Giles D. H. Snyder* for Columbia Gas Transmission Corporation

Paul W. Fox and *John S. Schmid* for Delmarva Power & Light Company

Norman A. Flanigan, Charles R. Brown and *George L. Weber* for Consolidated Natural Gas Service Company, Inc.

Henry P. Sullivan for Consolidated Gas Supply Corporation

Edward S. Kirby, James R. Lacey, William R. Duff and *Carl W. Ulrich* for the Public Service Electric & Gas Company

Joseph P. Stevens, Barbara M. Gunther and *Michael W. Hall* for The Brooklyn Union Gas Company

John T. Miller, Jr., for Elizabethtown Gas Company

Stephen H. Watts II for Commonwealth Natural Gas Corporation

William I. Harkaway, Garrett Austin, G. Douglas Essy and *John M. Cutler, Jr.*, for Consolidated Edison Company of New York, Inc.

Richard A. Solomon, Sheila S. Hollis, Peter H. Schiff and *Dennis Lane* for the Public Service Commission of the State of New York

Dale A. Wright and *Gregory Grady* for Public Service Company of North Carolina, North Carolina Natural Gas Corporation, and Piedmont Natural Gas Company, Inc.

Susan A. Low for Washington Gas Light Company

John T. Stough, Jr., for Atlanta Gas Light Company

Ira G. Megdal for South Jersey Gas Company

Jack M. Irion for United Cities Gas Company

Linda S. Mounts and *Ronald D. Eastman* for Burlington Industries, Inc.

Richard A. Oliver, Richard P. Noland and *Edward J. Grenier, Jr.*, for Cannon Mills Co., Cone Mills Corporation, Nabisco, Inc., Pine Hall Brick & Pipe Corporation

Edward G. Bauer, Jr., Eugene J. Bradley and *Donald Blanken* for Philadelphia Electric Company

William J. Benham for Texaco, Inc.

Barry J. Hart and *Stephen Schachman* for Philadelphia Gas Works

Stephen Watts for CNG Transmission Company

Morton L. Simons for North Carolina Utilities Commission

Keith R. McCrea and *Wayne W. Whitney* for Corning Glass Works, Lithium Corporation of America, Sayles Biltmore Bleacheries, Inc., and The Torrington Company

Frederick H. Ritts for the City of Danville, Dan River, Inc., and Philip Morris, Inc.

Norman A. Pedersen and *Michael A. Kelly* for the Staff of the Federal Energy Regulatory Commission

GROSSMAN, PRESIDING ADMINISTRATIVE LAW JUDGE:

PROCEDURAL HISTORY

On July 30, 1976, Transcontinental Gas Pipe Line Corporation (Transco) tendered for filing in Docket No. RP76-136 revised tariff sheets reflecting an $81.3 million rate increase, based on the twelve months ending April 30, 1976, as adjusted for known and measurable changes through January 31, 1977. Transco requested that the proposed rate increase become effective on September 1, 1976. By order issued August 30, 1976, the Commission[1] accepted the revised tariff sheets for filing and suspended their use for five months until February 1, 1977, when they were permitted to become effective, subject to refund.

On December 30, 1976, Transco tendered for filing in Docket No. RP77-26 revised tariff sheets to increase its rates for interruptible transportation services rendered under Order No. 533[2] to various industrial consumers. Transco had been charging 22 cents per Mcf plus fuel and line loss for transporting "533" gas anywhere on its system and had not proposed to increase this rate in its filing in Docket No. RP76-136. Transco proposes to increase its rates for interruptible transportation to 28.2 cents per dekatherm (dth) in Transco's rate Zone 1, 28.8 cents per dth in Zone 2, and 31.5 cents per dth in Zone 3 plus fuel.

This increase in rates for transportation of "533" gas would result in approximately $275,000 in additional revenues annually, based on the test period volumes presented by Transco in Docket No. RP76-136. Transco requested an effective date of January 31, 1977. By order issued on January 31, 1977, the Commission accepted for filing the revised tariff sheets tendered December 31, 1976, and

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[1] Commission refers to the Federal Power Commission prior to October 1, 1977, and to the Federal Energy Regulatory Commission thereafter.

[2] *Policy With Respect to Certification of Pipeline Transportation Agreements,* Docket No. RM75-25, Order No. 533, 6 F.P.S. 5-803 (August 28, 1975), *codified at* 18 CFR §2.79 (1977).

suspended them for one day, permitting them to become effective, subject to refund on February 1, 1977. Docket No. RP77-26 was consolidated with Docket No. RP76-136 for purposes of hearing and decision.

On March 30, 1977, Transco tendered for filing in Docket No. RP77-48 revised tariff sheets to increase further the rates for long haul interruptible transportation service to 42.8 cents per dth for Zone 1, 45.8 cents for Zone 2, and 49.4 cents for Zone 3 plus fuel. Transco requested an effective date of April 1, 1977. Transco also filed a request with the Administrator of the Emergency Natural Gas Act of 1977 (ENGA)[1] in Docket No. E77-83 to charge the Docket No. RP77-48 rates, effective April 1, 1977, for all ENGA gas which Transco purchases and transports as agent for certain of its customers and for all ENGA gas which Transco transports for others. Transco's prior practice had apparently been to transport emergency gas, whether purchased under Section 2.68 of the Commission's Regulations or ENGA, without charge other than for fuel and line loss.

The Administrator initially allowed Transco to charge the rates filed in Docket No. RP77-48. *Emergency Order Pursuant to Section 6 of Pub. L. 95-2,* Docket No. E77-83, April 4, 1977. By letter dated April 27, 1977, however, the proposed rates in Docket No. RP77-48 were rejected by the Commission for noncompliance with Section 154.63 of the Commission's Regulations. On May 23, 1977, the Commission denied Transco's application for rehearing of the rejection. Accordingly, on June 1, 1977, in Docket No. E77-83 Transco proposed new, lower transportation rates for ENGA gas, effective April 1, 1977, equivalent to the rates in effect subject to refund in Docket No. RP77-26. On June 10, 1977, the Administrator approved these lower rates, stating that such rates would be collected subject to refund pending resolution of the transportation rate issue in Docket Nos. RP76-136 and RP77-26. *Supplemental Emergency Order*

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[1] Act of February 2, 1977, Pub. L. No. 95-2, 91 Stat 4.

Pursuant to Section 6 of Pub. L. 95.2, Docket No. E77-83, June 10, 1977.

On June 28, 1977, Piedmont Natural Gas Company, Inc., Public Service Company of North Carolina, Inc., and North Carolina Natural Gas Corporation (North Carolina Companies) filed a motion requesting that the Commission order Transco to reduce its interruptible transportation rates to levels which would not result in the recovery of revenues in excess of Transco's claimed cost of service in Docket No. RP76-136, and to refund all excess revenues. By order issued October 31, 1977, the Commission denied the North Carolina Companies' motion noting that if the motion were granted, the rate for certificated interruptible transportation service would be 22 cents per dth and the rate for transportation of ENGA Gas would effectively be zero. The Commission in *Crab Run Gas Company, et al.,* Docket No. CP76-24, *et al.,* Order issued July 22, 1976, had found the 22 cents per dth rate is less than fully compensatory. The Commission concluded,

> Under the complex and unusual circumstances presented in this case, the Commission's authority to order refunds, with interest, of all amounts in excess of Transco's claimed cost of service in Docket No. RP76-136, and its power to order the additional refund, with interest, of all amounts ultimately found not to be justified, is sufficient to protect the public interest.

Transcontinental Gas Pipe Line Corporation, Docket Nos. RP76-136 and RP77-26, Order issued October 31, 1977, mimeo ed. at 6.

A prehearing conference was convened on January 4, 1977. On July 25, 1977, following settlement conferences and the filing of prepared direct testimony, a hearing was convened for the purpose of submission of evidence and cross-examination. The hearing in this case was phased so that at the session commenced on July 25, 1977, cross-examination was conducted only on cost of service issues. Rate design

issues, including the issue of interruptible transportation rates, were deferred until September 27, 1977. The July 25, 1977, cost of service phase of the hearing lasted two days and resulted in 609 pages of transcript: Volume 2, pages 9-459 and Volume 3, pages 460-618.

The rate design phase of the hearing was convened on September 27, 1977, but was recessed for the purpose of allowing further attempts to achieve a settlement. On November 1, 1977, the parties appeared before the Presiding Judge to request certification of a proposed settlement agreement (Exhibit 51) to the Commission for its consideration and disposition.

The proposed agreement resolved all issues which had arisen in this proceeding except four: (1) rate base treatment of certain advance payments, (2) rate base treatment for unsuccessful alternate gas supply costs, (3) rate of return on equity and (4) carrying charges on unrecovered demand charge credits. The issue of rate base treatment for certain advance payments was severed from this proceeding by order issued October 21, 1977, and is to be resolved in the consolidated proceeding in *Transcontinental Gas Pipe Line Corporation,* Docket Nos. RP74-48 and RP75-3 (AP76-1), *et al.* The unsuccessful alternate gas supply costs issue is to be determined by the outcome of *Transcontinental Gas Pipe Line Corporation* v. *Federal Energy Regulatory Commission,* No. 77-1712 in the United States Court of Appeals for the District of Columbia Circuit. The remaining two issues of rate of return and carrying charges on unrecovered curtailment credits are reserved and are the subjects of this decision.

On November 3, 1977, the Presiding Administrative Law Judge certified the proposed settlement agreement and the associated record to the Commission. Initial comments on the agreement were filed on November 16, 1977. Transco, Staff, and all but three parties either supported the settlement agreement in its entirety or did not oppose the agreement. Additionally, Mesa Petroleum Company filed a petition to intervene out of time and a comment opposing Article V of

the agreement regarding a "tracking" of advance payments.

In the November 3, 1977, certification of the proposed settlement agreement, the Presiding Judge as required by the Rules of Practice, also reported to the Commission an oral motion made by Counsel for the North Carolina Utilities Commission pursuant to Section 1.30(c) of the Commission's Rules of Practice and Procedure for omission of the initial decision on the two reserved issues of rate of return and carrying charges on unrecovered demand charge credits. The Commission has not issued an order on the proposed settlement agreement, although the motion for omission of the initial decision was denied. Order Denying Motion to Omit Initial Decision, issued December 19, 1977.

On July 1, 1977, Transco tendered for filing in Docket No. RP77-108, a proposed $50.8 million rate increase. Transco requested that the rate increase become effective on August 1, 1977. By order issued on July 20, 1977, the Commission accepted the proposed rate increase for filing and suspended it for five months until January 1, 1978, when it will be permitted to become effective, subject to refund. Accordingly, as of January 1, 1978, the rates proposed in Docket No. RP76-136 and RP77-26 will be for the "locked-in" period February 1, 1977 to December 31, 1977.

Initial briefs on the reserved issues were filed by Transco, Staff, The Public Service Commission of the State of New York (NYPSC), and the North Carolina Utilities Commission (NCUC). Briefing was completed by the filing of reply briefs by the same parties on January 27, 1978.

TRANSCO'S RETURN ON EQUITY

Transco seeks a return on equity of 17.0%. Based on the January 31, 1977, capital structure presented by Staff witness

Adelman,[4] an overall return of 10.12% would result. Staff argues the return on equity should be 14.0%, yielding an overall return of 9.39%. The NYPSC urges adoption of a rate of return on equity between 13.5 and 13.75%, while the NCUC contents itself by demanding a rate "not to exceed the just and reasonable level." No specific rate is proposed, but clearly the NCUC believes it to be somewhat less than 13.5%.

We start from the premise that a pipeline will recover all its allowed cost of service, including a just and reasonable return, if its cost-based rates are set by allocating properly the pipeline's costs to the volumes to be sold or transported within the period at issue. Whether the pipeline operates at 100% capacity or, as Transco, operates at 50% capacity under seasonal curtailment, full recovery of costs and return will result if the projected costs and volumes are accurate.[5]

Transco states it has no reason to suspect the accuracy of its projections as to costs and volumes. It is assumed the tendered settlement agreement, which includes agreement as to cost of service issues, reasonably reflects Transco's projections. The risk to Transco's investors is that the projected volumes are too high or the projected costs too low. The risk to Transco's ratepayers is precisely the opposite.

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[4]

	Amount	Ratio	Cost	Weighted Cost
	(000)			
Long-Term Debt	$ 952,614	63.02%	7.92%	4.99%
Preferred Stock	192,146	12.71	8.12	1.03
Account 281	2,630	0.17	-0-	-0-
Common Equity	364,154	24.10		
Total	$1,511,544	100.00%		

Exhibit 17, p. 1.

[5] NCUC argues Transco's operation at 50% capacity indicates lack of efficient and economical management and should not be rewarded. The record is barren of evidence to support such a charge and it will not be considered further.

These risks, among others, must be balanced in determining the rate of return on equity to be allowed Transco.

Transco premises its request for a 17% return on the arguments that gas supply to the Transco system is critical and is a risk falling mainly on investors; that Transco's capitalization (24.10% common) is the thinnest of any major pipeline, thus deserving of a high return and that Transco should be equated to the "higher earner" electric utilities for purposes of determining a just and reasonable return.

Transco's witness Field refers to recommended (or at least accepted) rates of return on common equity of 14.75% in each of Transco's last three rate cases, all of which were settled. In the first two (RP74-48 and RP75-3), common equity ratios were 23.69%; in the third (RP75-75), the ratio was 25.10%. (Transco questions any Staff position arguing for a return of less than that agreed to in the three settled cases.) Having stated Transco's contention, it will not be considered. Settlements are precisely that which they are intended to be—disposition by agreement, doing no violence to the public interest. They are not in any respect precedential, nor should they be. There exists no basis to determine how they were reached, what compromises, if any, were made, or on what reasoning they were accepted. Transco's requested return will have to be justified, if it can be, on other grounds.

Transco's concern for future earnings is summarized by witness Field:

> My major worry is five years down the road, 10 - 15 years down the road, will we in our cost calculations derive costs and derive prices to recoup those costs which will, when the market test is applied, allow the company full cost of service recoupment.

Certainly, this would be a valid, and perhaps overriding concern were rates here proposed for a period of ten or more years. This, however, is not the case. It is obvious that we are dealing here with a locked-in period of only 11 months, and

there is nothing to suggest Transco intended the effective period of the rates in question to be longer, much less the 10 - 15 year period forecast. Inasmuch as annual (or more frequent, if possible) filings are the norm, projections are constantly revised, refined and updated. The risk inherent in inaccuracy is soon subject to correction. Thus, we deal not with possibilities of the distant future but with probabilities of annual projections. As long as this situation persists, the basic premise warrants that accurate projections will yield full return.

Although Transco faces formidable gas supply problems, it faces no risk that whatever volumes it has will not be sold. To the extent competition is a factor with respect to Transco's system, it is the competition among Transco's customers for Transco's gas.

Transco attempts to equate the risks it faces to those faced by electric utilities. In so doing, witness Field draws an analogy between Transco and the "higher earners" among the electrics. Unless the Commission is to abandon the historic distinction in return determinations between gas and electric utilities, and unless one were to ignore completely the extreme capital intensive nature of an industry required by law to meet projected demand, Transco's argument simply cannot be accepted. The Presiding Judge is not prepared even to recommend that the Commission consider such a departure from historic practices of rate making.

Finally, Transco, on brief, refers to recent Commission opinions authorizing returns as high as 13.50% and 13.75% on common ratios higher than that of Transco. This, perhaps, might support a requested return in that range; it certainly lends no support to Transco's requested 17% return.

Transco's requested return on common equity is without reasonable justification by Transco, and certainly no other party supports that rate. There is no other conclusion to be reached other than that there is no evidence present to support the requested rate of return.

Staff urges 14% as a just and reasonable return. Citing the ever present tests enunciated by the Supreme Court in the *Hope* and *Bluefield* cases,[6] witness Adelman equated the business and financial risks of Transco to those of comparable utility groups, selecting, for comparison, the familiar Moody's 24 Utilities, FPC Class A & B Electrics, and FPC Major Class A & B Pipelines. His analysis, and in particular his conclusion that Transco, except for the exceptionally poor year of 1974, has kept pace with or exceeded the Major A & B Pipelines and the two electric groups in terms of return average on common equity. Witness Adelman concluded that Transco's decision to seek additional gas supply, rather than invest that capital in diversification into non-regulated ventures, makes it a somewhat greater risk than would be an average pipeline. Based upon his analysis, and consideration of allowed returns to other pipelines and their common equity ratios, a rate of return on common equity of 14% is recommended by Staff.

NYPSC urges a return of between 13.5 and 13.75%, discounting the consideration of Transco's thin equity ratio in Staff's presentation. It argues that Transco's achieved earnings per share, which have risen from $2.01 in 1975 to $2.21 in 1976 and to $2.40 for the first half of 1977, coupled with large investment tax credits, offset the risk commonly considered inherent in a thinly capitalized enterprise. Thus, it is argued, lower risk warrants lower return.

NCUC, as noted, opposes all proposed rates of return, but does not suggest what it considers proper. Nor does it set forth any criteria designed to enable a rational determination.

Upon consideration of the record and the positions of the parties summarized above, it is concluded that Transco poses greater risks to investors than does virtually any other pipeline company, but that these risks are not of such magnitude as to

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[6] *F.P.C.* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944). *Bluefield Water Works and Improvement Company* v. *Public Service Commission*, 262 U.S. 679 (1923).

warrant significant departure from comparable ventures having somewhat fewer risks. Transco's ability not only to survive but to achieve modest prosperity in the face of its severe gas supply situation attests to its inherent strength in the marketplace. For a company such as Transco, a relatively narrow zone of reasonableness exists within which a just and reasonable rate of return on equity should be. That zone extends from 13.50%, below which the return to Transco would be below that available on investments in other enterprises having corresponding risks, and confidence in its fiscal integrity would not be assured, and 14.30%, above which the return to Transco would be excessive at the expense of the ratepayers.

Within this zone, the capital structure and risk analysis of Transco justify determination of the rate of return to be allowed on common equity at 14%, slightly higher than the midpoint of the zone of reasonableness, and amply supported by Staff's analysis.

INTEREST ON UNRECOVERED DEMAND CHARGE CREDIT BALANCE

Transco extends a credit on each customer's demand charges to the extent that the customer is curtailed. This credit is recovered by Transco through a surcharge on volumes of gas actually delivered, thus distributing the burden of curtailment more evenly.

As originally proposed, Transco includes the balance of unrecovered demand charge credits in working capital. Staff opposes rate base treatment for the unrecovered demand charge credits. NYPSC and NCUC do not take any position on this matter. Staff witness Chinn noted that the Commission's Regulations do not provide for carrying charges in the form of return and taxes on the balance, and observed that Transco can eliminate the problem of carrying an unrecovered curtailment credit balance by amending its tariff to allow "current collection" of credits. The tariff provision would allow Transco to estimate the credits it will be

extending in a month and estimate the actual sales during the month to enable Transco's recovery of the amount credited during the month in which the credit is extended.

Transco's witness Mullendore indicated Transco would accept a tariff revision to provide for "current collection" as an alternative to its originally proposed inclusion of the unrecovered demand charge credit balance in working capital.[7] Switching to the "current collection" basis, however, would, as of the day of the switch, leave Transco holding an unrecovered balance in its deferred account for demand charge credits. Transco proposes to recover this "locked-in" balance by way of a surcharge which would appear on customers' bills for each of the six months following effectiveness of the tariff. Transco proposes to collect interest on the balance until it is amortized through the surcharge.

Transco asserts that allowance of carrying charges is the necessary and proper rate treatment to make Transco whole with respect to its costs associated with unrecovered demand charge credits. To the extent that recovery of demand charge credits has been deferred, Transco claims it has collected less revenues than necessary to recover its current costs, thus resulting in costs for which Transco should be compensated.

Staff does not oppose Transco's surcharge proposal, but does oppose the proposal to collect interest on that balance. Staff notes the amount on which Transco seeks to collect

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[7] The Settlement Agreement in these dockets, pending Commission action, provides for Transco to file revised tariff sheets reflecting rate recovery of curtailment credits on a current basis. Such filing was made December 1, 1977, in Docket No. RP78-25, wherein Transco filed revised tariff sheets proposed to be effective January 1, 1978, to provide current recovery and for collection of carrying charges at 9% per annum on the unrecovered curtailment credits during the period February 1, 1977, until the unrecovered balance is eliminated at July 1, 1978. In its filing, Transco agreed that collection of such carrying charges, which total $1,469,672, would be subject to refund with interest, depending on the outcome of the reserved issue herein.

interest is not an amount which was borrowed nor on which Transco is paying any carrying charges. (Transco's customers were never billed this amount, nor was it owed by them.)

Staff argues Transco should not be allowed interest on the "purely paper" amount of accumulated unrecovered demand charge credits. Staff claims Commission policy is clear: carrying charges are not to be allowed on deferred account balances. For example, it notes, "carrying charges will not be allowed on any balances pertaining to unrecovered purchased gas costs" 18 C.F.R. 154.38(d)(4)(iv)(c) (1977). Staff analogizes the instant proposal to the "fuel surcharge" situation in Opinion No. 790, *Public Service Company of New Hampshire,* Docket No. ER76-285 (March 21, 1977); *Maine Public Service Company,* Docket No. E-8264 (June 27, 1977); and *Virginia Electric Power Company,* Docket No. ER76-415 (June 20, 1977). It asserts the unrecovered curtailment credit balance here is, in material respects, similar to the locked-in deferred fuel cost balances at issue in those cases. (If the entire surcharge to recover the unrecovered fuel cost balance were disallowed in those cases, Staff contends, interest should not be allowed here.) Transco agrees that Section 154.38(d)(4)(iv)(c) of the Commission's Regulations does not permit carrying charges on any balances of unrecovered purchased gas costs. It argues, however, that this establishes no policy in this area because in Order No. 452-A, the order on rehearing of the order adopting the PGA regulations, the Commission stated (37 F.R. 12489, June 24, 1972):

> El Paso Natural Gas Co., and Columbia Gas Transmission Corp., object to carrying charges not being allowed on balances pertaining to unrecovered purchased gas costs. El Paso suggests that these amounts constitute working capital. Ratemaking treatment of this item shall be considered on the merits when the issue is raised in rate proceedings for individual companies. The last sentence of §154.38(d)(4)(iv) will be changed by omitting reference to excluding amounts in Account 186 from rate

base. It should be noted that this subsection does not require interest to be paid by companies with excess balances.

Staff's reliance on three "fuel surcharge" cases involving attempts by electric utilities to collect a fuel surcharge is misplaced, according to Transco, because those cases did not involve interest or carrying charges, but rather the justification for collecting a fuel surcharge. In summary, Transco argues Staff has not justified denial of the carrying charges on unrecovered demand charge credits.

Whether Staff has or has not justified denial of the sought imposition of carrying charges is not the threshold question. That question properly is whether Transco has justified inclusion of the carrying charges.

In the absence of any clear policy or regulation, and treating the matter individually on the merits presented here, in accordance with the general guidance of Order No. 452-A, it is clear that Transco, having the burden of proving the provision to be just and reasonable, has failed to do so. (Merely to aver a provision is appropriate because nothing specifically prohibits it is no showing at all.) Contrary to Transco's claim, denial of inclusion of interest on carrying charges will not result in any cost for which Transco will not be compensated. Denial of interest on carrying charges means only that Transco will be compensated fully for the carrying charges but will not be allowed an additional return on them in the form of interest. If interest on carrying charges is analogous to any other sought recovery, it is analogous to the "fuel surcharge" situation, despite Transco's protestations. Just as in the case of fuel adjustments, carrying charges could have been billed and collected on a current basis. That Transco chose not to do so until now does not create justification to expose ratepayers to additional liability.

Transco, therefore, shall eliminate from its filing any interest charges on unrecovered demand charge credit balances.

ULTIMATE FINDINGS AND CONCLUSIONS

(1) Applicant, Transcontinental Gas Pipe Line Corporation, is a "natural gas company" subject to the provisions of the Natural Gas Act, and the sales of natural gas subject to the order which follows as a part of this Decision are sales of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission.

(2) The increased rates, which are the subject of this Decision, except to the extent heretofore specifically disapproved, are shown to be just and reasonable, and to the extent heretofore specifically disapproved, are found to be excessive.

(3) The just and reasonable rates and charges are, under the applicable provisions of the Natural Gas Act, those which are in conformity with the views, findings and conclusions set forth in the Decision herein.

WHEREFORE, IT IS ORDERED, subject to review of the Rules of Practice and Procedure of the Commission, that:

(A) Within 30 days from the issuance of this Decision or final disposition of the above-described Settlement Proposal, whichever is later, Transcontinental Gas Pipe Line Corporation shall refund to its customers any amounts collected in excess of those found just and reasonable as specified in the discussion above, together with interest from the date of payment to the date of refund, at the interest rate prescribed by the Commission's Regulations as amended on July 14, 1976, in Docket No. RM74-18, Order No. 513-A.

(B) Within 30 days after making the refunds required by paragraph (A), Transcontinental Gas Pipe Line Corporation shall file with the Commission in writing and under oath, a report as to the amount of refunds made and the method of their calculation, together with releases from all customers to whom refunds have been made.

/s/ STEPHEN L. GROSSMAN
Stephen L. Grossman
Presiding Administrative Law Judge

Office-Supreme Court, U.S.
FILED
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ALEXANDER L. STEVAS,
CLERK

No. 80-2143

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

Transcontinental Gas Pipe Line Corporation,
Petitioner,

v.

Federal Energy Regulatory Commission

ON CROSS-PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Brief For N.C. Natural, *et al.* In Opposition

Donald W. McCoy
McCoy, Weaver, Wiggins,
Cleveland & Raper
P.O. Box 2129
Fayetteville, North Carolina 28302

F. Kent Burns
Boyce, Morgan, Mitchell, Burns
& Smith, P.A.
P.O. Box 2479
Raleigh, North Carolina 27602

Gregory Grady*
Littman, Richter, Wright
& Talisman, P.C.
1050 17th Street, N.W., Suite 600
Washington, D.C. 20036
(202) 331-1194

Jerry W. Amos
Brooks, Pierce, McLendon,
Humphrey & Leonard
P.O. Drawer U
Greensboro, North Carolina 27402

Attorneys for
North Carolina Natural Gas Corporation
Public Service Company of North Carolina, Inc.
and Piedmont Natural Gas Company, Inc.

July 17, 1981
*Counsel of Record

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission may require a natural gas company to demonstrate that the rate increases which such company has sought are "just and reasonable" under the Natural Gas Act, and, where the company has failed to carry this burden of persuasion, order the company to refund the portion of the increased rates found not justified.
2. Whether the Commission may honor provisions in a prior Commission-approved rate settlement agreement specifically stating that neither the Commission nor any other parties to such settlement will be bound in future rate cases by matters settled therein.

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No. 80-2143

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

Transcontinental Gas Pipe Line Corporation,
Petitioner,

v.

Federal Energy Regulatory Commission

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Brief For N.C. Natural, *et al.* In Opposition

North Carolina Natural Gas Corporation, Public Service Company of North Carolina, Inc., and Piedmont Natural Gas Company, Inc. (N.C. Natural, *et al.*)[1] hereby jointly submit their Brief In Opposition to the cross-petition filed in this docket on June 17, 1981 by Transcontinental Gas Pipe Line Corporation (Transco).

OPINIONS BELOW

The opinion of the Court of Appeals (FERC Pet. App. A, pp. 1a-27a)[2] is reported at 642 F.2d 1335. The orders of

[1]In accord with Rule 28.1, N.C. Natural, *et al.* state that they are corporations which have no parent companies, but which have the following subsidiaries and affiliates: Carolina Energy Company, Inc.; NCNG Exploration Corporation; Piedmont Exploration Company, Inc.; Tar Heel Energy Corporation.

[2]Copies of the opinion and orders of the court below and the pertinent statutory provisions appear in the Appendix to the Petition for a Writ of Certiorari filed on May 18, 1981 by the Federal Energy Regulatory Commission in No. 80-1937.

the Federal Energy Regulatory Commission (Commission)[3] which are pertinent to Transco's cross-petition are not reported and appear in Apendices A and B to Transco's cross-petition, at pp. 1a-2a and p. 3a, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on September 24, 1980. Various timely petitions for rehearing and suggestions for rehearing *en banc* filed by, *inter alia*, Transco were denied on December 18, 1980, with the exception of the replacement of one paragraph in the Court of Appeals' opinion. By orders issued March 13, March 18, and April 16, 1981, the Chief Justice extended the time for filing petitions for a writ of certiorari to and including May 17, 1981. On Monday, May 18, 1981, the Commission, the North Carolina Utilities Commission (NCUC), and N.C. Natural, *et al.* petitioned this Court (in Nos. 80-1937, *et seq.*) for writs of certiorari as to "cost allocation" issue in this case. Transco's cross-petition as to the other issue of "rate of return" was filed June 17, 1981 pursuant to Rule 19.5 of this Court's Rules. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b).

STATUTES INVOLVED

Sections 4 and 5(a) of the Natural Gas Act, 15 U.S.C. §§717c and 717d, set out in FERC Pet. App. I, at pp. 63a-65a.

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[3]Under the Department of Energy Organization Act of 1977, 42 U.S.C. §§7101, 7172(a)(1)(B), the Federal Energy Regulatory Commission succeeded (in October of 1977) to most of the functions and responsibilities of the former Federal Power Commission under the Natural Gas Act. The term "Commission" herein refers to either the Federal Energy Regulatory Commission or the Federal Power Commission, as appropriate.

STATEMENT OF THE CASE

The Court of Appeals' opinion below reviewed the Commission's determination as to two issues regarding a wholesale rate increase filed with the Commission under Section 4 of the Natural Gas Act (Act) by Transco, a major natural gas pipeline system serving the eastern seaboard of the United States. The Commission (in No. 80-1937), NCUC (in No. 80-1938) and N.C. Natural, *et al.*[4] (in No. 80-1939) have petitioned this Court for certiorari only as to the D.C. Circuit's reversal, without remand, of the Commission's determination of the proper cost allocation to be reflected in Transco's increased rates. Transco now seeks in its cross-petition review also of the Court of Appeals' affirmance of the Commission's determination of the proper rate of return to be reflected in Transco's increased rates.

A. Statutory Framework

Section 4(d) of the Act requires that a natural gas company seeking to increase its interstate wholesale rates file new rate schedules with the Commission, as Transco did in its rate filing here at issue (FERC Pet. App. I, pp. 63a-65a, 15 U.S.C. §717c(d)). Under Section 4(e), the Commission may suspend the effectiveness of such new rates for up to five months, and enter upon a hearing concerning the *lawfulness* of the new rates. Section 4(a) of the Act declares that "[a]ll rates and charges [of] any natural gas company . . . shall be just and

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[4]N.C. Natural, *et al.* are natural gas distributing companies which purchase natural gas from Transco and resell such gas to residential, commercial and industrial consumers within the States of North Carolina and South Carolina. N.C. Natural, *et al.* actively participate on a regular basis in Transco's wholesale rate increase proceedings at the Commission.

reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful," and Section 4(b) declares that "[n]o natural gas company shall . . . (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges . . . or any other respect, either as between localities or as between classes of service" (FERC Pet.App. I, p. 63a, 15 U.S.C. §717c(a), (b)). At the end of the suspension period, the new increased rates may be collected, but such collection is subject to the hearing and a decision, in which the Commission may order the natural gas company "to refund, with interest, the portion of such increased rates or charges by [the Commission's] decision found not justified" (FERC Pet. App. I, p. 64a, 15 U.S.C. §717c(e)). Further, "[a]t any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural gas company..." (FERC Pet. App. I, p. 64a-65a, 15 U.S.C. §717c(e)).

Section 5(a) of the Act permits the Commission to investigate rates already in effect, providing that "[w]henever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State Commission or gas distributing company, shall find that any rate [or] charge . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate [or] charge to be thereafter observed and in force, and shall fix the same by order***" (FERC Pet.App. I, p. 65a, 15 U.S.C. §717d(a)).

B. The Commission Orders

This proceeding began on July 30, 1976, when Transco filed with the Commission pursuant to Section 4 of the Act a general wholesale rate increase wherein Transco

sought, *inter alia*, to increase its rates in each of its three geographical sales rate zones.[5] The Commission suspended these increased rates for the full statutory period, permitting them thereafter to become effective, subject to refund, under Section 4(e) of the Act.

Transco's increased rates reflected numerous changes in claimed costs and in the proportional allocations of such costs to its various rate schedules, including (1) an increase in Transco's claimed rate of return on equity capital from 14.75 percent to 17.00 percent, and (2) an allocation of transmission costs which resulted in a greater percentage increase to the rates in Zones 1 and 2 than to the rates in Zone 3. Ultimately, virtually all of the many issues as to the increased rates were resolved by a Commission-approved settlement. However, the two issues of the rate of return and the cost allocation reflected in the increased rates were among those reserved for separate, phased hearings and decision.

In the rate of return hearing, Transco sought to carry its burden under Section 4 of the Act to demonstrate the justness and reasonableness of its increased rates reflecting its claimed rate of return on its equity of 17.00 percent. The Commission staff witness introduced evidence in support of an equity return of 14.00 percent, somewhat below the equity return reflected in Transco's prior-existing rates, which rates had been the product of past rate settlements which had resolved numerous issues (including cost allocation) in prior rate cases. However, those past settlements only resolved such issues for the limited time periods to which those

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[5]Transco's pipeline system extends from the gas production areas in Texas and Louisiana through rate Zone 1 (the states of Mississippi, Alabama and Georgia), Zone 2 (South Carolina, North Carolina, Virginia and the District of Columbia), and Zone 3 (Pennsylvania and New York).

settlements were applicable. On February 3, 1978, the Administrative Law Judge (ALJ) issued an initial decision, holding that Transco had failed to justify an equity return of 17.00 percent, and adopted the Commission staff witness' recommendation that such return should be 14.00 percent. The ALJ rejected Transco's argument that the Commission was powerless to reduce the rate of return the company had achieved through prior limited-term settlements, except prospectively, after a full Section 5(a) investigation in which the Commission bore the burden of proof (Transco Cross-petition, App. C, p. 12a). Transco appealed the ALJ's decision on rate of return to the Commission, and on August 30, 1979, the Commission affirmed and adopted the decision of the ALJ (Transco Cross-petition, App. A, pp. 1a-2a).

As discussed in greater detail in N.C. Natural, *et al.*'s petition in No. 80-1939 (pp. 7-9), the Commission had issued on August 5, 1979 its Opinion No. 59 in which the Commission determined that Transco's increased rates were not just and reasonable in that such increased rates reflected a cost allocation which did not follow any recognized *method* of cost allocation but simply plugged into the rates certain cents-per-Mcf zone rate level differentials which had been reflected in prior rates negotiated in a 1962 rate settlement. The Commission found that "no adequate or proper basis had been shown to justify the continued application of [the] previously negotiated settlement rate differentials," (FERC App. F, p. 39a), as this procedure unfairly burdened Zone 1 and 2 customers with an increasingly disparate portion of Transco's transmission costs. The Commission determined that neither Transco, nor the supporters of the cost allocation reflected in Transco's increased rates had demonstrated that such rates were in this respect just and reasonable. The Commission ordered that Transco reflect in its

increased rates the well recognized Mcf-mile method of cost allocation, so that there would be "a proper apportionment of cost responsibility between and among Transco's customers" (FERC App. F, p. 39a).

C. The Opinion Below

Transco appealed the Commission's rate of return order, and certain Zone 3 distributor customers appealed the Commission's decision on the cost allocation issue, and the orders were reviewed together in the Court of Appeals.

On September 24, 1980, the D.C. Circuit reversed, without remand, the Commission's decision that the cost allocation reflected in Transco's increased rates had not been justified and its determination of the proper cost allocation to be reflected in such rates. The D.C. Circuit decided that before the Commission may pass upon the cost allocation reflected in Transco's increased rates, the Commission must undertake an investigation pursuant to Section 5(a) of the Act. In such an investigation, the Commission would bear the burden of persuasion, and the Commission's decision could only be applied prospectively and not retrospectively through refunds under Section 4(e) of the Act.

However, while reversing, without remand, the Commission's determination of the proper cost allocation, to be reflected in Transco's increased rates, the Court of Appeals affirmed the Commission's determination of the proper rate of return to be reflected in the increased rates. The Court of Appeals thus affirmed the Commission's finding that Transco had failed to meet its burden under Section 4 of the Act to demonstrate that its increased rates reflecting its claimed rate of return were justified, and the Commission's retroactive application of its decision (*i.e.*, the Commission's order that Transco must

recalculate its rates as they had been collected subject to refund, to reflect a lower rate of return and must make refunds of the excess revenues that had been collected under such rates).

REASONS FOR DENYING THE WRIT AS TO THE RATE OF RETURN ISSUE

Although N.C. Natural, *et al.* agree with Transco that the D.C. Circuit's rationale in its review of the transmission cost allocation determination is in fact totally inconsistent with the D.C. Circuit's affirmance of the Commission's rate of return determination, Transco's proposed resolution of this inconsistency is perversely to render *both* of the Court's decisions wrong. Instead of proposing to resolve the inconsistency by correcting the decision as to cost allocation, Transco proposes to *extend and compound* the Court of Appeals' error as to its novel interpretation of Sections 4 and 5 of the Act. This proposal would require an entirely inappropriate reversal (perhaps also without remand) of the Commission's rate of return determination.

The Court of Appeals' decision as to rate of return need not be reviewed by this Court because that decision is essentially correct. As discussed in N.C. Natural, *et al.*'s petition for certiorari as to the cost allocation issue (pp. 12-15), Transco filed *increased rates* with the Commission under Section 4(d) of the Act, and the levels of these increased rates necessarily reflected a myriad of ratemaking components, including, (1) Transco's claimed rate of return of 17.00 percent, and (2) Transco's proposed allocation of transmission costs, which increased rates in Zones 1 and 2 to a proportionally greater extent than in Zone 3. The Court of Appeals properly affirmed the Commission's decision that Transco had failed to carry its burden of persuasion that the claimed rate of return was justified, and the

Commission's order directing Transco to make refunds related thereto. Clearly, these actions were taken by the Commission under express powers granted by Congress in Section 4 of the Act. Transco's contention that the Commission does not have the power under Section 4 of the Act to suspend Transco's new increased rates and, after hearing, order full refunds with regard to the rate of return reflected therein, is totally untenable, and such contention is in no way aided by the D.C. Circuit's similar contention with regard to the cost allocation reflected in such rates. Both contentions simply fly in the face of the plain language of Section 4 of the Act.

The central error in Transco's argument, as well as in the D.C. Circuit's decision as to cost allocation, is found in Transco's repeated claim that the Act is concerned with so-called rate "components". Transco urges that even where a company has filed increased rates under Section 4 of the Act, the Commission is powerless to change the prior-existing "components" of these increased rates except prospectively, after a full Section 5 investigation in which the Commission bears the burden of proof (Transco Cross-petition, e.g., pp. 9-10). By "components", Transco presumably refers to those elements of cost which are reflected in an increased rate in "building block" fashion in the ratemaking process (including, among many other elements reflected in such increased rate, the elements of rate of return and cost allocation as discussed in N.C. Natural, *et al.*'s petition (pp. 12-13)). However, neither Section 4 nor Section 5, nor any other section of the Act makes mention of anything even vaguely resembling a rate "component". The Act speaks quite unambiguously of increased *"rates and charges"*, not *"components"* thereof (FERC Pet.,App. I, p. 64a):

> (e) Whenever any such new [rate] schedule is filed the Commission shall have authority,** to enter upon a hearing concerning the lawfulness of such *rate, charge,* classification or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such *rate, charge,* classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the *rate, charge,* classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective.** Where *increased rates or charges* are thus made effective, the Commission may,** upon completion of the hearing and decision, . . . order such natural-gas company to refund, with interest, the *portion of such increased rates or charges* by its decision found not justified. (Emphasis added)

Thus, when a pipeline *increases its rates,* as Transco did in this case, and regardless of the rate of return, cost allocation or other rate "components" reflected therein, the Commission has the power, clearly stated under the Act, to (1) suspend the effectiveness of those *increased* rates, (2) hold a hearing thereon, and (3) order refunds of the portion of the *increased rates* found unjustified. That is precisely what the Commission did as to both the rate of return and cost allocation reflected in

Transco's *increased rates* in this case, except that the Commission, in its discretion under Section 4, declined to order refunds of that portion of the increased Zone 1 and 2 rates found not justified as a result of the misallocation of costs reflected in those rates (FERC Pet. App. F, pp. 50a-52a).

Although N.C. Natural, *et al.* agree with Transco that the D.C. Circuit's opinion is not a model of clarity, it must be assumed that that Court believed that the Commission was correct in deciding the rate of return issue under Section 4. Otherwise, under the D.C. Circuit's theory of the meaning of Sections 4 and 5, expressed in the cost allocation section of its opinion, the Court would have to have reversed, rather than affirmed, the Commission on rate of return. Under the D.C. Circuit's theory, the Commission would have had no power under Section 4 of the Act to order the refunds of that portion of the revenues previously collected under the increased rates related to the difference between the 14.75 percent equity return reflected in Transco's prior-existing rates and the 14.00 percent adopted by the Commission.

Further, in its discussion of burden of persuasion, the Court of Appeals seemed to recognize that the Commission in the case at bar did not have this burden, as the Commission clearly would have had under Section 5 (FERC Pet. App. A, p. 24a):

> [W]e conclude that the Commission is not obliged to bear the burden of proving a change resulting from higher rates unjust. It need only conclude that the petitioner has failed to carry its burden of proof.

Nor is the fact that Transco's rate of return and cost allocations have been the subject of prior Commission-approved settlements in any way controlling as to the resolution of the proper rate of

return and cost allocation to be reflected in the rates in this case (Transco's Cross-petition, e.g., p. 12). Those settlements specifically provided that neither the Commission nor any other parties were to be bound in future rate proceedings by the settled matters therein.[6] Although, as pointed out in N.C. Natural, *et al.*'s petition in No. 80-1939 (pp. 19-26), the Court of Appeals ignored these non-binding provisions of the Commission-approved settlements with regard to the cost allocation issue, the Court of Appeals' affirmance of the Commission as to rate of return was *not* inconsistent with those provisions.[7]

It is therefore *not* the rate of return decision of the Court of Appeals which requires review, as that decision, unlike the Court of Apeals' decision as to cost allocation, is not in conflict with either the decisions of

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[6]N.C. Natural, *et al.* would note that the Commission in such settlements did not find either the prior rate of return or the prior cost allocation "just or reasonable" under the Act, in the sense of a finding made after full litigation of these issues, as apparently erroneously believed by the Court of Appeals (FERC Pet. App. A, p. 25a). These were approved only as part of the reasonable over-all settlements "in the public interest". *E.g., Transcontinental Gas Pipe Line Corp.*, 54 FPC 2150, 2155 (1975).

[7]As to Transco's further claim that the Court of Appeals failed to review properly the evidence as to rate of return, this is indeed an ironic contention in the context of Transco's basic concern as to the inconsistency of the Court of Appeals' decision as between the rate of return and cost allocation issues. As to the rate of return issue, that Court reviewed and discussed the evidence on all *sides* of the issue, including Transco's evidence. However, as to the cost allocation issue, the D.C. Circuit *ignored* the evidence supporting the Mcf-mile method adopted by the Commission; the D.C. Circuit discussed only the evidence which that Court believed supported the cost allocation which that Court determined was superior and which that Court imposed, without remand, on the Commission.

the Court or the decisions of other Federal Courts of Appeals.[8] *E.g. FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962); *Kansas-Nebraska Natural Gas Co.* v. *FPC*, 534 F.2d 227 (10th Cir. 1976).

However, Transco's cross-petition as to the rate of return issue does highlight the dangers of the D.C. Circuit's novel interpretations of the Act in the cost allocation portion of its decision. As discussed in N.C. Natural, *et al.*'s petition (pp. 13-15), the Court of Appeals' interpretation virtually would require the total nullification of the powers Congress specifically gave to the Commission, in plain words in Section 4 of the Act, to review fully a pipeline's increased rates. The Court of Appeals' interpretation would result necessarily in the Commission being helpless to change *any* so-called rate "component" which could be considered to have been in some way reflected in prior rates, except *prospectively* after a hearing in which the *Commission* bears the burden of proof. This would permit regulated companies in effect to ratchet upwards their rates by only proposing changes in those rate components which would tend to *raise* the rates, while leaving untouched those components which would tend to lower the rates (see N.C. Natural, *et al.'s* Petition, pp. 13-15). It is obvious that this was never contemplated by Congress, and is totally contrary to this Court's thorough discussion in *Tennessee Gas Transmission, supra,* of the risks borne by companies filing for increased rates under Section 4.

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[8]Transco's citation of this Court's decision in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) is totally inapposite. That case involved only the question of whether a pipeline company selling gas to a distributing company *under a fixed rate contract* "may, without the consent of the distributing company, change the rate specified in the contract simply by filing a new rate schedule" with the Commission under Section 4 (350 U.S. at 333-4). This Court held that such a filing was a nullity under

CONCLUSION

The cross-petition for a writ of certiorari as to the rate of return issue should be denied.

Respectfully submitted,

Donald W. McCoy
McCoy, Weaver, Wiggins, Cleveland & Raper
P.O. Box 2129
Fayetteville, N.C. 28302

F. Kent Burns
Boyce, Morgan, Mitchell, Burns & Smith, P.A.
P.O. Box 2479
Raleigh, N.C. 27602

Gregory Grady
Littman, Richter, Wright & Talisman, P.C.
1050 17th Street, N.W., Suite 600
Washington, D.C. 20036
(202) 331-1194

Jerry W. Amos
Brooks, Pierce, McLendon Humphrey & Leonard
P.O. Drawer U
Greensboro, N.C. 27402

Attorneys for
North Carolina Natural Gas Corporation
Public Service Company of North Carolina, Inc.
and Piedmont Natural Gas Company, Inc.

July 17, 1981

Section 4, but Transco's Section 4 filing herein was not contrary to any such fixed rate contract, nor was there any question raised as to Transco's right unilaterally to increase its rates. Only the Court of Appeals' decision to give the prior-existing cost allocation procedures precedential effect was violative of a contract (*i.e.* the prior Commission-approved rate settlement agreements, discussed *supra*).

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No. 80-2143

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Cross-Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MEMORANDUM FOR NORTH CAROLINA UTILITIES COMMISSION

MORTON L. SIMONS *
BARBARA M. SIMONS
1629 K Street, N.W.
Washington, D.C. 20006
(202) 293-1819

ROBERT P. GRUBER
P.O. Box 991
Raleigh, North Carolina 27602

Attorneys for
North Carolina Utilities Commission

July 17, 1981

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

COUNTERSTATEMENT OF QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission's determination to allow a natural gas pipeline a return on equity of 14% was adequately supported by an articulated rationale and substantial evidence.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-2143

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Cross-Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

MEMORANDUM FOR NORTH CAROLINA UTILITIES COMMISSION

The cross-petition filed by Transcontinental Gas Pipe Line Corporation in No. 80-2143 seeks review by this Court of a second issue—rate of return—involved in the court of appeals decision in *Public Service Commission* v. *F.E.R.C.*, 642 F.2d 1335; the zone allocation issue in that decision is presently the subject of petitions for certiorari in Nos. 80-1937 (FERC), 80-1938 (North Carolina Utilities Commission), and 80-1939 (North Carolina Natural Gas Co., *et al.*).

The proceeding before the Commission related to Transco's request, under Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, for increased rates for natural gas service for the period February 1 - December 31, 1977.

As part of its filing, Transco requested a rate of return on equity of 17.0%. Although at the hearing Transco's witness conceded that the highest return on equity ever allowed any interstate pipeline in a contested rate case was 13.75%, the Commission's rate-of-return witness testified that 14.0% would be an appropriate return for Transco, and this level was subsequently adopted by the Commission. Both before the Commission and on appeal to the court below, the North Carolina Utilities Commission challenged the 14.0% allowance as excessive on two grounds: first, that, without explanation or justification, it granted Transco a higher return than the highest ever allowed in a decided pipeline rate case; and, second, that it failed to discount the otherwise allowable return to reflect Transco's sharply curtailed level of service during the period in question. In contrast, Transco challenged the 14.0% allowance as inadequate, arguing, *inter alia*, that it was entitled to a 14.75% allowance since that figure had previously been accepted in *uncontested settlements* involving Transco's rates.

The court of appeals, rejecting both challenges to the rate-of-return determination, affirmed the Commission's allowance of 14.0%, and neither the North Carolina Utilities Commission nor Transco petitioned for a writ of certiorari on this point. Transco has, however, filed a cross-petition to the petitions filed by FERC and others on the zone allocation issue.

The North Carolina Utilities Commission respectfully submits that in the event the Court should determine to grant certiorari on the rate-of-return issue, the writ should encompass both halves of the issue that was before the Commission and the court of appeals: viz., whether the Commission's determination to adopt a 14.0% return on equity was justified in light of both Transco's

claim that the 14.0% return was inadequate and North Carolina's claim that it was excessive.

Respectfully submitted,

MORTON L. SIMONS
BARBARA M. SIMONS
1629 K Street, N.W.
Washington, D.C. 20006
(202) 293-1819

ROBERT P. GRUBER
P.O. Box 991
Raleigh, North Carolina 27602

Attorneys for
North Carolina Utilities Commission

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No. 80-2143

In the Supreme Court of the United States

OCTOBER TERM, 1980

TRANSCONTINENTAL GAS PIPE LINE CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

LAWRENCE G. WALLACE
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

CHARLES A. MOORE
General Counsel

JEROME NELSON
Solicitor

BARBARA J. WELLER
Assistant Solicitor
Federal Energy Regulatory Commission
Washington, D.C. 20426

QUESTION PRESENTED

Whether the court of appeals properly concluded that substantial evidence supported the determination of the Federal Energy Regulatory Commission, in a proceeding under Section 4(e) of the Natural Gas Act to review increased rates proposed by a pipeline company, that the pipeline failed to justify an increase in its rate of return on equity to 17% and that a 14% rate of return would be just and reasonable.

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In the Supreme Court of the United States

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FEDERAL ENERGY REGULATORY COMMISSION

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (FERC Pet. App. 1a-27a),[1] as amended (FERC Pet. App. 32a-33a), is reported at 642 F. 2d 1335. The relevant orders of the Commission (Cross-Pet. App. 1a-2a, 3a) and the opinion of the administrative law judge (Cross-Pet. App. 4a-19a) are not reported.

JURISDICTION

The judgment of the court of appeals (FERC Pet. App. 28a-31a) was entered on September 24, 1980. Petitions for rehearing were denied on December 18, 1980 (FERC Pet. App. 32a-33a, 34a, 35a). The Chief Justice extended the

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[1] "FERC Pet. App." refers to the appendix to the Commission's petition for a writ of certiorari in No. 80-1937.

time for filing a petition for a writ of certiorari to and including May 17, 1981, and the Commission's petition was filed on May 18, 1981 (a Monday).[2] Transco's cross-petition was filed on June 17, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

STATUTE INVOLVED

Sections 4 and 5(a) of the Natural Gas Act, 15 U.S.C. 717c and 717d(a), are set forth at FERC Pet. App. 63a-65a.

STATEMENT

Transcontinental Gas Pipe Line Corporation ("Transco"), an interstate natural gas pipeline company, sells natural gas for resale subject to the jurisdiction of the Federal Energy Regulatory Commission under the Natural Gas Act, 15 U.S.C. 717 *et seq.* In 1976 Transco filed a general rate increase with the Commission under Section 4 of the Natural Gas Act, 15 U.S.C. 717c. Transco's request for increased rates included a proposal to increase its rate of return on equity capital from 14.75% to 17%. Pursuant to its authority under Section 4(e) of the Act, 15 U.S.C. 717c(e), the Commission suspended the increased rates for five months and ordered a hearing on the justness and reasonableness of the new rates. Most of the issues relating to the increased rate filing were resolved in a settlement approved by the Commission. However, two questions were reserved for separate hearings: (1) the justness and reasonableness of Transco's proposed increase in its rate of return on equity; and (2) the proper method of allocating transmission costs among the customers on Transco's system.

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[2]Separate petitions for a writ of certiorari were also filed on May 18, 1981, by the North Carolina Utilities Commission (No. 80-1938) and the North Carolina Natural Gas Corporation, *et al.* (No. 80-1939).

As to the first question, the Commission rejected Transco's request to increase its rate of return to 17%, finding that a 14% rate of return was just and reasonable. As to the second question, the Commission rejected Transco's method of cost allocation and ordered Transco to change its method of allocating transmission costs. The court of appeals affirmed the Commission's rate of return decision and reversed the Commission's cost allocation decision. The Commission's petition for a writ of certiorari in No. 80-1937 seeks review of the cost allocation portion of the decision below. Transco's cross- petition seeks review of the rate of return portion of the court of appeals' decision.

In his decision on the rate of return issue, the administrative law judge determined that a 14% return on equity for Transco was within a "zone of reasonableness" (Cross-Pet. App. 15a). In reaching this determination, the judge reviewed the evidence submitted by Transco (*id.* at 11a-13a), which, as noted above, proposed to increase its return on equity from 14.75% to 17%, and the evidence submitted by the Commission's staff (*id.* at 14a), which recommended that Transco be allowed a 14% return on equity. Both presentations relied on traditional comparable earnings and risks analyses.

The administrative law judge concluded that Transco's evidence failed to justify its requested rate of return (Cross-Pet. App. 13a). In particular, he noted that although "Transco poses greater risks to investors than does virtually any other pipeline company, * * * these risks are not of such magnitude as to warrant significant departure from comparable ventures having somewhat fewer risks. Transco's ability not only to survive but to achieve modest prosperity in the face of its severe gas supply situation attests to its inherent strength in the marketplace" (*id.* at 14a-15a). Based on the record evidence, the judge found that the appropriate zone of reasonableness was one that

extended from 13.5%—the point at which confidence in Transco's fiscal integrity would be assured and below which Transco's return would be less than that for investments in other enterprises having corresponding risks—to 14.3%, above which the return to Transco would be excessive at the expense of the ratepayers (*id.* at 15a). He determined that a return of 14%, which was slightly above the midpoint of the zone of reasonableness, was "amply supported" by the analysis of the Commission's staff (*ibid.*).

The Commission affirmed and adopted the administrative law judge's rate of return decision (Cross-Pet. App. 1a-2a). In affirming the Commission's order concerning the rate of return issue (FERC Pet. App. 21a-26a), the court of appeals held that substantial evidence supported the Commission's decision permitting Transco a 14% rate of return on equity and that the Commission's decision was based on "settled methodology" (*id.* at 26a).

ARGUMENT

The principal question presented in the Commission's petition in No. 80-1937, seeking review of the court of appeals' cost allocation decision, is whether a natural gas company's statutory burden of justifying an increased rate, under Section 4(e) of the Natural Gas Act, 15 U.S.C. 717c(e), applies only to the "changed" portions of the new rate, with the Commission bearing the burden, under Section 5(a) of the Act, 15 U.S.C. 717d(a), of showing that "unchanged" elements of the new rate are unjust and unreasonable before the Commission may order changes in those elements. As explained in our petition for certiorari, we believe the court of appeals erred in concluding that the Commission must comply with the requirements of Section 5(a) before it may order changes in *any* component of a

filing for increased rates. Transco's cross-petition seeks to present, in the event the Commission's petition is granted, the further question whether the court of appeals properly concluded, in its decision on the rate of return issue, that the Commission satisfied the requirements of Sections 4(e) and 5(a) of the Act in permitting Transco to collect a rate of return on equity of 14%. We adhere to the position that the requirements of Section 5(a) do not apply in the context of a Commission proceeding to review any aspect of an increased rate filing. But even if we are incorrect in our construction of the statute, there is no occasion for the Court to grant Transco's cross-petition for certiorari because, as the decision below demonstrates, Transco would, in any event, not be entitled to relief under the court of appeals' interpretation of the Act.

1. It is well settled that so long as a rate adopted by the Commission is "within a 'zone of reasonableness,' " the "courts are without authority to set [it] aside." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968). See *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979). That "zone of reasonableness" test was clearly satisfied in this case.

The rate of return issue arises from Transco's filing of increased rates with the Commission pursuant to Section 4 of the Natural Gas Act. As a part of that filing, Transco proposed to increase its rate of return on equity to 17%.[3] Section 4(e) of the Act, 15 U.S.C. 717c(e), provides that at any hearing involving a rate sought to be increased, "the burden of proof to show that the increased rate * * * is just and reasonable shall be upon the natural-gas company." Following a hearing, the administrative law judge found that Transco failed to carry that burden and, based on

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[3]Transco's pre-existing rate of return on equity had been 14.75%, in accordance with settlements reached in its three prior rates cases.

expert testimony, selected 14% as the most reasonable rate within a zone of reasonableness extending from 13.5% to 14.3%. The judge expressly found that any return above 14.3% "would be excessive at the expense of the ratepayers" (Cross-Pet. App. 15a). In affirming the Commission, the court of appeals concluded (FERC Pet. App. 24a-25a n.27) that:

> [T]he Commission complied with the requirements of sections 4(e) and 5(a) of the Natural Gas Act in making its rate-of-return determination. Reading sections 4(e) and 5(a) together, we conclude that the Commission is not obliged to bear the burden of proving a change resulting from higher rates unjust. It need only conclude that petitioner has failed to carry its burden of proof. Against a background of obvious conflict in credible testimony, the conclusion that Transco failed to carry its burden is inherent in the Commission's determination that any rate higher than 14.3% falls outside the zone of reasonableness.
>
> However, when the Commission not only voids a proposed rate increase, but institutes a rate of its own under section 5(a) rather than continuing the old rate in effect, it must adduce substantial evidence to prove (1) that the old rate is unjust and unreasonable and (2) the Commission's proposed rate is just and reasonable. The Commission's conclusion that only rates between 13.5% and 14.3% are just and reasonable and the substantial evidence that supports it fulfill the requirements of section 5(a) on both necessary findings.

Thus, contrary to Transco's contention (Cross-Pet. 9-11), the Commission did find that any rate above 14.3%, the upper limit of the zone of reasonableness, was unjust and unreasonable. That finding, of course, encompassed Transco's pre-existing rate of 14.75%, which had been incorporated in prior rate settlements, as well as Transco's proposed increase to 17%.

2. Transco argues (Cross-Pet. 11-12) that the decision below is inconsistent with *Columbia Gas Transmission Corp.* v. *FERC*, 628 F. 2d 578 (D.C. Cir. 1979), which held that the Commission must explain any departure from a long standing practice. Transco contends that its previous rate of return of 14.75% must be considered the point of departure against which any new rate must be measured. But questions of intra-circuit conflicts are for the courts of appeals, not this Court, to resolve. *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957). Cf. *Davis* v. *United States*, 417 U.S. 333, 340 (1974).

In any event, the court below correctly explained that the principles articulated in *Columbia Gas* have no application to Transco's rate of return contentions (FERC Pet. App. 24a-26a). Focusing upon the differing burdens faced by the administrative decisionmaker, the court noted (*id.* at 25a) that "[i]n *Columbia Gas*, the Commission was choosing between present practice and a discrete alternative" whereas "[h]ere the ALJ faced an infinitude of choices from a low of 13.5% to a high of 17% without any distinct point of departure." Even though in the past "[t]he Commission approved settlements of 14.75% rate as just and reasonable, [it] did not indicate that neighboring figures might not also be just and reasonable, or even more just and reasonable" (*ibid.*). As the court of appeals concluded (*id.* at 26a), "making the Commission explain why it did not choose every other plausible result when it is faced with a multitude of possible outcomes and with precedents whose relevance is a matter of judgment and which do not suggest any one settled practice is both unreasonable and unlikely to advance the cause of reasoned decisionmaking."

3. Finally, Transco contends (Cross-Pet. 13) that the court of appeals erred in failing "to require the Commission to demonstrate the same caliber of reasoned decisionmaking on the rate of return issue as it required on the zone

differential issue." At bottom, Transco challenges the findings of the court below that substantial evidence supports the Commission's rate of return decision and that there is insufficient evidence to sustain Transco's position. The court of appeals determined (FERC Pet. App. 22a-23a n.24) that "substantial evidence supports the portions of the ALJ's decision that justify a 14% return. The staff witness's estimate was adopted, and the Transco witness's estimate was not, because the ALJ and the Commission concluded in an exercise of their expert judgment that the staff witness's estimate of the risks facing Transco compared to those facing other gas pipelines was superior to the estimate made by Transco's witness."

In *Permian Basin Area Rate Cases, supra*, 390 U.S. at 791-792, this Court set forth the responsibilities of a reviewing court in considering the Commission's rate orders:

> First, it must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

The court of appeals properly performed these responsibilities. It upheld the Commission's rate of return decision after finding that the Commission had properly exercised its statutory authority (FERC Pet. App. 24a n.27). And it found that the Commission's decision was supported by

substantial evidence and was based on a settled ratemaking methodology (*id.* at 26a). The court of appeals' substantial evidence determination does not warrant further review. See *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 310 (1974); *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 491 (1951).

CONCLUSION

The cross-petition for a writ of certiorari should be denied.

Respectfully submitted.

LAWRENCE G. WALLACE
Acting Solicitor General

CHARLES A. MOORE
General Counsel

JEROME NELSON
Solicitor

BARBARA J. WELLER
Assistant Solicitor
Federal Energy Regulatory Commission

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No. 80-2143

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION

On Cross-Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

REPLY MEMORANDUM OF CROSS-PETITIONER TRANSCONTINENTAL GAS PIPE LINE CORPORATION

BRIAN E. O'NEILL, *Senior Vice President and General Counsel*
R. V. LOFTIN, JR.
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
P.O Box 1396
Houston, Texas 77215

THOMAS F. RYAN, JR.*
RICHARD T. BOONE
ANDREWS, KURTH, CAMPBELL & JONES
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 861-7400

Attorneys for Transcontinental Gas Pipe Line Corporation

August 31, 1981

*Counsel of Record.

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REPLY MEMORANDUM OF CROSS-PETITIONER TRANSCONTINENTAL GAS PIPE LINE CORPORATION

Because the court below inconsistently decided the two rate issues involved in this case, Transcontinental Gas Pipe Line Corporation (Transco) seeks review of the rate of return portion of the decision below if this Court reviews that aspect of the decision which decided the zone rate differentials issue raised in Petitions filed by the Federal Energy Regulatory Commission (Commission) in No. 80-1937, North Carolina Utilities Commission (NCUC) in No. 80-1938, and North Carolina Natural Gas Corporation, *et al.* (NCNG, *et al.*) in No. 80-1939. No party filing a brief in opposition to Transco's Cross-Petition claims that the decision below consistently decides the two rate issues. On the contrary, NCNG, *et al.*, expressly concedes the inconsistency, and NCUC implicitly concedes such inconsistency by not opposing

Transco's Cross-Petition. The Commission, while not directly addressing the foregoing claim of inconsistency, presents an argument which illustrates, rather than dispels, the inherent validity of Transco's claim of inconsistency.

1. To understand the arguments presented in opposition to Transco's Cross-Petition the nature of the inconsistency in the decision below merits reiteration. The decision below holds that Section 5(a) is applicable to *both* rate issues involved in this case, but it failed to apply Section 5(a)'s standards to the rate of return decision.[1] The Commission and other Petitioners challenge the holding that Section 5(a)'s requirements are applicable to the zone differentials issue but are silent on the holding that Section 5(a) is applicable to the rate of return issue, presumably because the result was favorable to these parties. Transco's complaint in its Cross-Petition is that, while giving lip service to the applicability of Section 5(a) to the rate of return decision, the court below did not in fact apply Section 5(a)'s standards to that issue. Thus, if this Court grants certiorari only as to the zone differential issue, there will remain an inconsistency between the two issues, either as to the basic issue of whether Section 5(a) governs or as to the manner in which it is applied. Only by taking both issues can the Court straighten out this inconsistency.

2. NCNG, *et al.*, while forthrightly recognizing the inconsistency in the decision below, urges this Court to

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[1] The court below held that when the Commission not only voids a proposed increase in return under Section 4 of the Natural Gas Act but also sets aside the pre-existing rate of return in favor of its own determination, it must proceed under Section 5(a) of the Act. FERC Pet. App. A, pp. 24a-25a, n.27. Thus, the reduction of Transco's pre-existing rate of return determination from 14.75 percent to 14.00 percent is governed by the standards of Section 5(a).

single out the zone differentials issue, presumably because these parties wish to preserve what they now perceive to be a favorable result on the issue of rate of return.[2] However, having recognized the inconsistency below, there is simply no logic to their position that only one of these issues should be resolved by this Court.

3. The Commission argues that, even if the court below was correct in determining Section 5(a) to be applicable to the rate of return issue, the court below correctly held that the Commission had statisfied the requirements of Section 5(a) and, therefore, the rate of return decision should not be reviewed. Besides the fact that the Commission claims that Section 5(a) does not apply to rate of return any more than to zone rate differentials and that the applicability of correct standards is the basis of the Commission's Petition in these cases, the Commission's argument lacks credibility. In the first place, the Commission never purported to decide the rate of return issue pursuant to Section 5(a) and adamantly insists that it would be erroneous to require that it do so. Secondly, the Commission's rate of return order itself (Cross-Pet. App. C, p. 12a) demonstrates conclusively that the Commission *ignored* Transco's pre-existing rate of return allowance in deciding the case; that the Commission would now argue that such cavalier disregard of a pre-existing rate component is the equivalent of the reasoned focus on an established lawful rate component required by Section 5(a) is totally unconvincing.[3] Moreover, it is apparent from the Commission's con-

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[2] These parties never took a position on the merits of the rate of return issue in any of the proceedings below.

[3] Proof positive that the Commission's argument is disingenuous is the fact that the rate of return *result* would have been quite different had the court below actually applied Section 5(a), where any change in the pre-existing rate of return would have been prospective from the date of the Commission's decision.

voluted argument opposing review of the rate of return issue that the court below improperly interjected itself in the administrative process by finding (1) that the Commission inadvertently complied with statutory standards which the Commission itself has consistently refused to recognize as applicable, and (2) by creating a rationale on behalf of the Commission that would support affirmance of the rate of return orders. However, since the Commission does *not* subscribe to the rationale of the court below on the rate of return issue (and indeed could not do so without undermining its argument that the zone rate differentials issue should be reviewed), the basis for its opposition to Transco's Cross-Petition is totally unavailing.

4. Unlike NCNG, *et al.*, NCUC did take a position on Transco's rate of return before the Commission and preserved the issue by appealing the rate of return decision to the court below. However, NCUC's position was rejected in the court of appeals and it failed to file a timely petition for certiorari or a cross-petition on that aspect of the decision below. Accordingly, NCUC cannot at this late date petition this Court for review of this adverse decision in the court below.[4]

CONCLUSION

For the foregoing reasons, Transco's Cross-Petition for review of the rate of return portion of the decision

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[4] The court below (FERC Pet. App. A, p. 21a) found "nothing in the record to warrant our disturbance of the Commission's judgment [in discussing NCUC's allegations]." This is not surprising, because NCUC failed to introduce any evidence in hearing to support its claims. This ruling by the court below, however, is not inconsistent with any portion of the court's decision on zone rate differentials, and NCUC should not be allowed to bootstrap review of an issue that it did not preserve simply because Transco has preserved its issue dealing with the same subject matter, *i.e.*, rate of return.

below should be granted, if the Petitions in Nos. 80-1937, 80-1938 and 80-1939 are granted.

Respectfully submitted,

BRIAN E. O'NEILL, *Senior Vice President and General Counsel*
R. V. LOFTIN, JR.
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
P.O Box 1396
Houston, Texas 77215

THOMAS F. RYAN, JR.
RICHARD T. BOONE
ANDREWS, KURTH, CAMPBELL & JONES
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 861-7400

Attorneys for Transcontinental Gas Pipe Line Corporation